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***By Federal Express***

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Missouri Public Service Commission

Mr. Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge
Missouri Public Service Commission
Truman Building, Fifth Floor
301 West High Street, Room 530N
Jefferson City, MO 65101

Re: Union Electric Company (Ameren UE),
Case Nos. EO-96-14 and EM-96-149

Dear Mr. Roberts:

In connection with the above-referenced matter, enclosed for filing with the Commission are an original and fifteen (15) copies of the Reply Brief of Union Electric Company, d/b/a Ameren UE.

Please "file-stamp" the additional copy and mail it back to me in the enclosed, self-addressed stamped envelope. Thank you for your assistance in bringing this filing to the attention of the Commission, and please call if you have any questions.

Very truly yours,

Craig S. Lerner

Craig S. Lerner

Enclosures

MISSOURI PUBLIC SERVICE COMMISSION

Case No. EO-96-14
Case No. EM-96-149

# POST-HEARING REPLY BRIEF OF UNION ELECTRIC COMPANY


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ST. LOUIS, MISSOURI
August 1999

175

MISSOURI PUBLIC SERVICE COMMISSION

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## TABLE OF CONTENTS

## TABLE OF AUTHORITIES

**Page**

**Cases**

**Page**

BEFORE THE PUBLIC SERVICE COMMISSION
STATE OF MISSOURI

| | | |
|---|---|---|
| In the Matter of the Monitoring of the | ) | |
| Experimental Alternative Regulation Plan of | ) | Case No. EO-96-14 |
| Union Electric Company | ) | Case No. EM-96-149 |

## REPLY BRIEF OF UNION ELECTRIC COMPANY

Comes now Union Electric Company ("Union Electric," "UE" or "the Company") to respectfully submit this brief in reply to the Initial Briefs submitted by the Staff of the Missouri Public Service Commission (the "Staff") and by the Office of Public Counsel ("OPC").

### PRELIMINARY STATEMENT

Now that all the parties have put before the Commission their main effort to illuminate the record for the benefit of the Commission's deliberations in this case, it is, we respectfully submit, painfully clear that this record provides *no* basis, much less *substantial* and competent evidence, by which the Commission can lawfully order the adjustments to UE's earnings calculations proposed by the Staff and OPC. This judgment is unavoidable, as we will explain below, when one simply holds up the record and the claims made by the Staff and OPC to the well-established principles governing this Commission's evaluation of evidence and decisionmaking.

At the outset, we must note that OPC, perhaps increasingly aware of the lack of evidence supporting the adjustments at issue, as in its Initial Brief for the first time attempted to argue that Union Electric, not the proponents of these adjustments, bears the burden of proof. The Staff has not joined OPC in this, to put it mildly, tardy claim. This argument, as we will show below, can be disposed off quite readily, for in this case the Commission has already ruled that the proponents have the burden of proof. Moreover, the Commission's ruling simply reflects the result the law requires, and to change the burden now -- after these proceedings have from the beginning been structured based on the Staff and OPC having the burden of proof -- would violate the most elementary understanding of procedural due process under both the Missouri and United States Constitutions.

Clearly, OPC's sensitivity to the burden of proof is well-founded, given that they and the Staff have failed to adduce the substantial and competent evidence needed to satisfy their burden. As we will demonstrate below, nothing in either the Staff's or OPC's Initial Brief seriously challenges the conclusion from our Brief and Proposed Findings of Fact and Conclusions of Law that on many key matters, the proponents of the adjustments at issue have advanced here simply their bare conclusions unsupported by competent and relevant evidence. As the Commission itself has pointed out, this will not do. *See Re Missouri Pub. Serv.*, 152 PUR 4th 333, 339, 343 (Mo. P.S.C. 1994) (where OPC had nominally contested two issues, but had "offered no evidence . . . to support any particular finding" as to those issues, the Commission had "no basis on which to find in favor of OPC"); *Re Union Electric Co.*, 25 Mo. P.S.C. (N.S.) 194, 1982 Mo. PSC LEXIS 34, at *92 (accepting the utility's position because no other party had introduced contrary evidence). Where a party bears the burden of proof, it must produce substantial evidence to warrant a finding in its favor. *Re Southwestern Bell Tel. Co.*, 24 Mo. P.S.C. (N.S.) 279, 1981 Mo. PSC LEXIS 45, at *24; *Staff v. Union Elec. Co.*, 29 Mo. P.S.C. (N.S.) 313, 90 P.U.R. 4th 400, 1987 Mo. PSC LEXIS 3, at *29.

Even where the proponents have introduced some evidence, it falls far short of the *substantial* evidence required for this Commission's decisions to pass muster on review.

The proponents' failure to meet this essential evidentiary threshold is, as we will explain, sometimes a function of the small quantum of evidence they have offered, *see Staff v. Union Elec. Co., supra*; *Re Kansas City Power & Light Co.*, 21 Mo. P.S.C. (N.S.) 543, 1977 Mo. PSC LEXIS 9, at *127 (direct conflicts in the record left the Commission "without clear and convincing evidence"), and sometimes a function of internal inconsistencies and ambiguities in the testimony of their witnesses, *see Re Terre Du Lac Utils. Corp.*, 26 Mo. P.S.C. (N.S.) 165, 1983 Mo. PSC LEXIS 44, at *26 (The Commission will "rule against the party which has the burden of proof" in cases where the evidentiary record is so "confused" that it cannot discern the true facts.).

In short, even if the Commission simply concluded that the record was confused, or found itself unable to resolve conflicts in the evidence, the principles of law that govern here require the Commission to reject the adjustments proposed by the Staff and OPC, as the parties bearing the burden of proof. But thoughtful scrutiny of the record will not lead to confusion. It will reveal that the Staff and OPC at best offer the Commission the most superficial conclusions about the earnings calculations they wish to adjust, conclusions unanchored either to facts that justify their adjustments or to legal analyses showing how these adjustments could be even remotely authorized under the statutory powers of the Commission or the Stipulation and Agreement, Docket No. ER-95-411 (June 12, 1995) (Exh. No. 13, Attachment A of Appendix A to Rebuttal Testimony of Donald E. Brandt) ("Agreement") by which the experimental alternative regulation plan ("EARP") was created.

## Argument

### I. THE PROPONENTS OF THE ADJUSTMENTS AT ISSUE BEAR THE BURDEN OF PROOF BY SUBSTANTIAL AND COMPETENT EVIDENCE.

OPC's claim, OPC Br. at 11-13, that UE bears the burden of disproving the accuracy of the adjustments at issue is squarely foreclosed by Commission Order. The Commission has already held: "As the Staff and Public Counsel have come forward with their objections to the earnings report filed by AmerenUE, *Staff and Public Counsel bear the burden of proving that their objections are valid and correct.*" *Order Denying Requests for Commission Guidance and for an Order Establishing Further Proceedings With Respect to the Meaning of the Governing Legal Standard and Order Establishing Procedural Schedule*, Case No. EO-96-14 ("March 18 Order") at 6 (emphasis added).

In a motion filed in response to the March 18 Order, the Company wrote that "the Commission correctly noted that the 'Staff and Public Counsel bear the burden of proving that their objections are valid and correct.'" *Union Electric Company's Motion to Strike Portions of the Direct Testimony of Stephen M. Rackers, Arlene S. Westerfield and Michael G. Gruner* (April 1, 1999). The Staff filed a response to the Company's motion, in which it did not contest this point. *Staff Response in Opposition to Union Electric Company's Motion to Strike Portions of the Direct Testimony of Stephen M. Rackers, Arlene S. Westerfield and Michael G. Gruner* (April 12, 1999). OPC was, of course, served with the Company's motion to strike, but it failed to file any responsive pleadings.

Remarkably, months after the March 18 Order -- and despite the fact that it never filed a motion for reconsideration or clarification when the Order was entered -- OPC apparently seeks to revisit the issue. Still more remarkable is OPC's failure, anywhere in its three-page treatment of the issue, to acknowledge the Commission's explicit holding in the March 18 Order. In short, the OPC had failed to articulate an argument as to why the Commission should reverse its already-stated position on the evidentiary burden.

Furthermore, OPC's recently unveiled position conflicts with the established rule that the party seeking to change the status quo bears the evidentiary burden. In *Re Missouri Public Service*, Case No. ER-97-394, *et al.*, 1998 Mo. PSC LEXIS 21, for example, the Commission imposed the burden on the Staff "because [the regulated company] did not propose any changes to the status quo, but Staff did." *Id.* at *18. The Commission has regularly imposed the burden of proof on parties seeking to "show the reasonableness of [a] proposed change," not on parties seeking to sustain the status quo. *Re Southwestern Bell Tel. Co.*, 95 P.U.R. 3d 328, 332 (Mo. P.S.C. 1972). Here, the Company, complying with the Reconciliation Procedure set out in the Agreement, applied the same accounting methodologies it used in the First and Second Sharing Periods, as well as prior to the EARP, to calculate its Third Sharing earnings. The Staff and OPC are proposing adjustments that represent dramatic breaks from this established practice under the EARP (which is, under the terms of the Reconciliation Procedure, the Company's established practice in keeping its books and records, and so dates from well before the EARP). Because the proposed adjustments obviously seek a departure from the status quo, Commission precedent dictates that the Staff and OPC bear the evidentiary burden.[1]

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[1] The OPC's proposed shifting of the burden also conflicts with the principle that where a party "alleges that a regulated utility is violating the law, its own tariff, or is otherwise engaging in a unjust or unreasonable actions, the burden of proof at hearing rests with complainant." *Trigen-St. Louis Energy Corp. v. Union Elec. Co.*, Case No. EC-96-164, 1997 Mo. PSC LEXIS 129, *7. *See also Sheldon Marquilis v. Union Elec. Co.*, 30 P.S.C. (N.S.) 517, 523 (1991); *Staff v. Union Elec. Co.*, 29 Mo. P.S.C., 90 P.U.R. 4th 400, 1987 Mo. PSC LEXIS 3, *13 (imposing the burden on complainants, who "initiated these complaint cases," to prove the unreasonableness of "particular cost[s] of plant items"). Here, the Staff and

OPC's claim that the burden should be shifted because of the Company's "intimate knowledge of the facts which are at issue" (OPC Br. at 13) merits little response. As Staff counsel observed when the Commission approved the EARP in 1995, the Agreement ensures that the parties are able to monitor UE's compliance. Transcript, Case. No. ER-95-411 (July 19, 1995) ("EARP Presentation") (Exh. No. 47), at 36. Specifically, Section 3.e requires that the Company make numerous documents available for review; in addition, the parties "may follow up with data requests, meetings and interviews, as required, to which UE will respond on a timely basis." Agreement, § 3e.[2]

Finally, at this stage in the proceedings, shifting the burden to the Company would entail a dramatic unfairness and would violate the Company's due process rights. In establishing the respective burdens of the parties here, the Commission related the allocation of burdens to the sequence in which testimony was filed:

> As Staff and Public Counsel have come forward with their objections to the earnings report filed by AmerenUE, Staff and Public Counsel bear the burden of proving that their objections are valid and correct. The direct testimony filed on February 23 by Staff and Public Counsel will be accepted as their direct testimony. The Company may file its rebuttal to the issues Staff and Public Counsel raise in their objections. Staff and Public Counsel will be permitted to respond to the company's testimony in surrebuttal.

March 18 Order at 6. As a result of the Commission's conclusion that the Staff and OPC bore the burden of proof, the Company had only one opportunity to file written

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OPC are alleging that the Company failed to comply with the Agreement; it should, as a matter of law and common sense, bear the burden of proving its allegations.

[2] In addition, OPC's argument proves too much: the Company is *always* the party most familiar with its own activities. The logic of the OPC argument would mean that the Company would *always* bear the burden of proof -- which, of course, is simply not the case. In numerous proceedings, on a variety of issues, the Company does not bear the burden of proof. For example, in a complaint case, the complainant, not the regulated utility, bears the burden of proof. *See supra* at n.1.

testimony. Moreover, the Company was limited in the subjects that it could raise in its filings to "the issues Staff and Public Counsel raise in their objections."

Even more problematic, in reasonable reliance on the March 18 Order, the Company approached this proceeding on the assumption that the Staff and OPC bore the burden of proof. Consistent with basic principles of fairness, reflected in the due process protections of the United States and Missouri Constitutions, the Company cannot be informed *after the hearing and after the opportunity to present evidence has passed* that, despite the clear statement in the March 18 Order, it bears the burden of proof. After all, the March 18 Order shaped the Company's approach to the proceeding. In *Matter of Missouri Public Service*, Case No. ER-97-394, *et al.*, 1998 Mo. PSC LEXIS 21, the Commission made clear that even where "no evidence was presented by [the regulated company]" it "successfully rebutted the evidence presented by Staff," and therefore the "Staff failed to meet its burden of proof." *Id.* at *19. With this in mind, Union Electric here has demonstrated the faulty nature of each of the Staff's proposed adjustments; the Commission therefore must reject the adjustments, as a matter of law, even had UE not offered any evidence of its own.

True, the Company went beyond what was required and introduced affirmative evidence demonstrating the validity of its own calculations. For example, with respect to the Company's Year 2000 related software maintenance expenses, we did what the Staff failed to do, that is, we put those expenses in the context of the kind of software maintenance UE must regularly undertake -- maintenance often critical to UE's safe and reliable operations -- in order to determine whether the Year 2000 maintenance expenses was either a new category of costs, or was "extraordinary" in some way. By any realistic measure, either in terms of the significance of the work or the amount of the costs, they were not. If, however, UE had the burden of proof, the Company would have offered much more detailed testimony, from its computer technicians and others, to more fully make its case. We did not do this, however, because it was the proponents of adjustments to these expenses who had the burden of showing that these expenses were a new category of costs or were somehow "extraordinary."

Similarly, with respect to the territorial agreements, the Company proved that, contrary to the Staff's allegations, it has realized an increase in net income as a result of the exchanges of customers. If, however, the Company had been informed prior to the hearing that it bore the burden of proof, it might have taken additional measures to demonstrate the soundness of its calculations. To prove that the Black River agreement was an immediate success (as reflected by an increase in net income), the Company might have subpoenaed records from the Black River cooperative relating to customers the cooperative received from UE. But the Company did not seek to track down such evidence for the simple reason that it did not have the burden of doing so. The Staff did.

Simply put, to shift the burden of proof now, and, as a result accept the proposed adjustments, would be to fault the Company after the fact for failing to do that which it was not required to do. If, notwithstanding the law and its earlier-stated position, the Commission now holds that the Company bears the burden of proof, at the very least it would be required to give notice to the Company and provide an opportunity for the submission of further evidence, as well as afford the Company another evidentiary hearing. The failure to do so would violate UE's due process rights. In *Tackett v. Benefits Review Bd.*, 806 F.2d 640 ($6^{th}$ Cir. 1986), for example, the Court reversed the agency's decision because the allocation of the burden of proof changed after the hearing. The court wrote: "As petitioner points out, there was no reason for her to provide testimony on this issue because . . . the law at the time of the hearing, held that lung cancer was a chronic lung disease sufficient to invoke the presumption." *Id.* at 642.[3] As the Supreme Court has held, "a State must afford to all individuals a *meaningful* opportunity to be heard if it is to fulfill the promise of the Due Process Clause." *Boddie v. Connecticut*, 401 U.S. 371, 379 (1971) (emphasis added). Manifestly, UE would have been deprived such an opportunity were it appraised, *after the hearing*, of the level of evidence expected of it to rebut the Staff's and OPC's adjustments.

## II. NEITHER THE RECORD NOR THE ARGUMENTS OFFERED BY THE STAFF OR THE OPC ESTABLISH THAT THE COMMISSION HAS THE AUTHORITY TO ORDER THE PROPOSED ADJUSTMENTS.

### A. The Commission Does Not Have Any Authority Independent of the Agreement to Order the Proposed Adjustments.

1. Neither the Staff nor OPC directly challenges the proposition that the Commission does not have the independent authority to compel a utility to participate in an earnings sharing plan. Of course such a challenge would hardly have been credible, for under unassailable principles of Missouri law, the Commission simply does not have the quasi-judicial power to order a utility to refund part of the rates it has been paid. *See* UE Br. at 40. They similarly do not dispute the equally unassailable proposition that, just as the Commission does not have the power to order a refund scheme in the first instance, so it does not have the power to order a change in the amount to be refunded. Yet several

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3 *See also Bendix Corp. v. FTC*, 450 F.2d 534, 541 (6th Cir. 1971) (the Company "was entitled an opportunity to defend against the theory upon which the Commission acted," and "[n]umerous . . . examples can be given of how the case would have been tried differently," if the Company had been *informed, prior to the hearing, of an issue upon which it bore the burden of proof*); *Rodale Press v. FTC*, 407 F.2d 1252, 1257 (D.C. Cir. 1968) ("By substituting an issue . . . for the one framed by the pleadings, the Commission has deprived petitioners of both notice and hearing on the substituted issue.").

of the claims they make only make sense if the Commission does have such authority. In short, they assume, without making any effort to prove, a Commission power that is squarely at odds with this well-established body of law.

In one example, the Staff makes the claim, intended as a criticism, that Union Electric essentially "seeks to make GAAP binding for ratemaking purposes" by our point that the Reconciliation Procedure starts with the Company's books and records, which are prepared consistently with GAAP, with discrete adjustments thereafter. Staff Br. at 3-4. This claim is wrong at several levels. Most obviously, the Reconciliation Procedure does not set or determine rates, and so does not make *anything* binding for "ratemaking purposes." The Commission itself made this clear in its proceedings on the Southwestern Bell plan:

> [T]he alternative regulation plan does not set rates. No rate is changed as a result of the plan and no determination as to the overall level of rates is made. The sharing that would occur under the plan is done through credits to a customer's bill each year. These credits are based upon SWB's ROE but the credits do not result in a rate reduction, nor will rates increase if SWB fails to earn at a certain level. Rates are set as found in this Report And Order and those rates will remain in effect until the Commission reviews SWB's rates in a subsequent general rate proceeding.

*Re Southwestern Bell Telephone Co.*, Case Nos. TC-93-224 and TO-93-192, 1993 Mo. PSC LEXIS 62, at * 250 (Dec. 17, 1993).

Moreover, both the text of the Reconciliation Procedure, and *all* the evidence in the record, confirms that the calculation of UE's return on equity under the Reconciliation Procedure works exactly as we have described: one starts with the figures in the Company's books and records, and then makes the adjustments to which the signatories agreed. *See* Proposed Findings of Fact ("PFOF") Nos. 28, 29. Indeed, this understanding of the Reconciliation Procedure is apparent even if one wishes to take the

Staff's position that they have the power to propose changes to the adjustments set out there. Even Mr. Rackers explained the calculation of the refund as we do. Rackers Dir., at 2 (lines 20-22) (Exh. No. 1) ("The achieved equity return is based on the average capital structure, the average rate base and the booked earnings, as adjusted, during the particular one year sharing period."). Yet the Staff offers the Commission no competing reading of the Reconciliation Procedure to suggest that the Procedure works in some different manner. Do they claim that the books and records of the Company are at odds with GAAP? (If so, has the Staff reported this state of affairs to the SEC? Of course, no evidence supports such a preposterous notion.) And if there is no specific adjustment set out in the Reconciliation Procedure addressing a particular item -- and, from the Staff's perspective, no unilateral change to the Procedure has been ordered -- doesn't the accounting for that item in calculating UE's return on equity come from the Company's books and records? As a result, isn't GAAP "binding" with respect to that item?

Certainly, if the Commission can order a change to the Reconciliation Procedure without the concurrence of all the signatories, it can change an accounting treatment that would otherwise apply under the Reconciliation Procedure, regardless of whether that treatment conformed to GAAP. But, as we noted above, the Staff has not claimed that the Commission has such an independent power. The fact that GAAP does not bind the Commission in the normal ratemaking context has no significance whatsoever in terms of the provisions of the bargain by which Union Electric agreed to enter into an earnings sharing regime. The Commission had the opportunity to withhold its approval of the EARP if the role of GAAP in the Company's books and records was somehow troublesome to it. However, the Commission did approve the EARP, and that approval has not changed the basic fact that the Commission has no power from any source outside of the EARP by which it can order changes to the Reconciliation Procedure.

2. Similarly, none of the cases cited by the Staff, *see* Staff Br. at 22-37, have any relevance to the circumstances of this case, for all those cases involve an issue of the Commission changing course when there was no question that the Commission had the authority to act in the first place. Here, the proponents of the adjustments do not ask the Commission simply to withdraw its approval of the EARP -- something the Commission could do under certain conditions, but a step not without serious legal consequences of its own -- rather they ask the Commission to change the agreed-upon calculations for the sharing of UE's earnings. The Commission, again, had no authority to set up this earnings sharing regime in the first place, and not one of the cases cited by the Staff even remotely suggests how the Commission could possibly have the power to change the terms of such a regime.

The case discussed at some length by the Staff, *State ex rel. Jackson County v. Public Serv. Comm'n*, 532 S.W.2d 20 (Mo. 1975), *cert. denied*, 429 U.S. 822 (1976), illustrates how all these cases miss the mark here. *Jackson County* arose out of an order of the Commission that set rates for Missouri Public Service Company "for a period of at least two years." *Jackson County*, 532 S.W.2d at 23 (quoting Report and Order, Case No. 17,763 (Dec. 14, 1973)). When the Commission later, but before two years had passed, authorized Missouri Public Service to raise its rates, several of Missouri Public Service's large customers, Kansas City and Jackson County, challenged the rate hike on several grounds, including the argument that the Commission did not have the authority to abrogate the original two-year "moratorium" on rate changes. *Id.* No one in *Jackson*

*County* claimed that the Commission did not have the authority to enter the first rate order, and, indeed, no one contended that the Commission did not have the authority to enter the second by itself. Neither order paid customers a refund or in any other way retroactively affected rates. The power of the Commission to act was not derived, for either order, from any agreement of third parties. Furthermore, no claim was made that a party had relied on the terms of the first order, expending its own resources in reliance on those terms to create investment-backed expectations. The question simply was the relationship between the two orders: that is, whether the Commission could set higher rates in the second order sooner than the first order said it would.

The Missouri Supreme Court, not surprisingly, held that the Commission could change its rate orders to meet changing conditions as the public interest required. *Id.* at 29. For the Staff and OPC to prevail here, however, one must reach a quite different conclusion: that the Commission's view of the public interest allows the Commission to give itself power it has not already been given by the Legislature, that is, to order that earnings be refunded by Union Electric on terms, and so in an amount, different from the bargain by which UE agreed to refund earnings. This, the Missouri Supreme Court in *Jackson County* did *not* say. Indeed, if the Commission had such a roving power to do whatever it thought best "in the public interest," no specific statutory delegation of power would ever be needed for the Commission to act, a notion that clearly is not the law. For example, if the Commission did have such a reservoir of power, it would not be correct to say, as Missouri courts have said repeatedly, *see* Brief at 40, that the Commission does not have the power to compel a utility to refund rates already paid.

In addition to not explaining where the Commission would get any power outside of the Agreements to order the proposed adjustments, neither the Staff nor OPC addresses the significance of the Agreement as a binding contract on any ability of the Commission to order the proposed adjustments and so change the terms of that Agreement. To be sure, neither the Staff nor OPC appear to challenge the fact that the Agreement is a settlement agreement and, therefore, a binding contract. *See* Staff Br. at 36 (quoting *State ex rel. Missouri Cable Telecommunications Ass'n v. Public Serv. Comm'n*, 929 S.W.2d 768, 774 (Mo. App. 1996), to the effect that "Missouri courts generally treat settlement agreements as contracts and we find no reason to view this settlement agreement [i.e., the Southwestern Bell experimental incentive regulation plan] any differently."). *See also* UE Br. at 15-19.[4]

Even if the Commission had some authority to impose the proposed adjustments independent of the Agreement -- which it does not -- that authority would be circumscribed by the contractual character of the Agreement. In this country, under the United States Constitution, and in this State, under the Missouri Constitution, agencies of government simply do not have the power to abrogate contracts willy-nilly, no matter how good an idea that might seem to some. *See State ex rel. Utility Consumers Council v. Public Serv. Comm'n*, 585 S.W.2d 41, 49 (Mo. 1979) ("'[N]either convenience,

[4] Since the contractual character of the Agreement, at least with respect to the signatories, has not been challenged here, the Staff's extensive summary of *Missouri Gas Energy v. Public Serv. Comm'n*, 978 S.W.2d 434 (Mo. App. 1998), *see* Staff Br. at 27-35, is puzzling. *Missouri Gas Energy* squarely implicated the Commission's well-established ratemaking power, for MGE was essentially claiming that an accounting treatment provided in an Accounting Authority Order ("AAO") was binding in subsequent rate proceedings. Regardless of whether or not the AAO was a contract, the court correctly rejected MGE's claim, since the express terms of the AAO provided that "the Commission reserves the right to consider the ratemaking treatment to be afforded these expenditures in any later proceeding." *Id.* at 438. Here, as we have established in our opening brief, UE Br. at 22-40, and describe further below, the Agreement provided no such express authority to the Commission to change the Reconciliation Procedure agreed to by the signatories.

expediency or necessity are proper matters for consideration in the determination of whether or not an act of the commission is authorized by the statute . . . .") (internal citation omitted). *See also* UE Br. at 41-47. As we explained in our opening brief, these constitutional protections for contract rights do not mean that contracts are absolutely immune from the proper exercise of governmental police powers. This Commission, of course, has been delegated certain of those powers. To abrogate or alter the terms of a contract without running afoul of the Contract Clauses of the United States or Missouri Constitutions, the courts have held that such an impact on contract rights must be only an "incidental" effect of a broader exercise of power. Such a proper exercise of the police power does not focus on changing contract rights, but establishes "a generally applicable rule of conduct designed to advance a broad societal interest." *Exxon Corp. v. Eagerton*, 462 U.S. 176, 191 (1983). Here, not only have the proponents of these adjustments not even hinted that such a "broad" rule is involved, but these adjustments are plainly not a consequence of any general exercise of the police power. These adjustments do precisely what the Contract Clauses do *not* permit, that is, their "sole effect [is] to alter contractual duties," and "directly adjust[] the rights and responsibilities of contracting parties." *Id.* at 192.

Moreover, we must remember, once again, that any agency can only exercise that share of the state's police powers that it has been given by the Legislature. Even if the Commission were to properly exercise its share of the police powers, in this context, as we have explained before, UE Br. at 40-41, these powers do not include changing the terms of an agreement to refund earnings. Rather, since the Commission's power in this context is limited to approval of the EARP, the only possible exercise of that power here would be a withdrawal of its approval of the whole EARP. Then, of course, no sharing credit at all would be due for the third sharing period, since the EARP would have been terminated

Finally, even if the Commission did properly exercise its police powers in this fashion, so that the Contract Clauses did not block that action, the Commission still would have taken UE's property rights, and the Company would be entitled to just compensation for that taking. *See* UE Br. at 47-52.

3. OPC seems to imply the existence of some source of authority, outside of any provision in the Agreement, for the Commission to modify the EARP in its discussion of the Commission's general statutory responsibilities. *See* OPC Br. at 10. Foremost among those responsibilities, of course, is the Commission's duty to ensure that rates are just and reasonable. OPC makes the unexceptional observation that the Agreement "does not obviate the Commission's obligation to protect the public." *Id.* But recognizing that undeniable legal principle does not support the quite different notion that the Commission has some inherent power to order the adjustments proposed here. OPC's argument conveniently forgets that the Commission has no statutory authority to compel any utility into an earnings sharing arrangement, and the fact that a utility voluntarily negotiates and enters into such an arrangement does not give the Commission broader authority unless the terms of that deal do so.

In the context of an earnings sharing plan, the Commission's "obligation to protect the public" is satisfied in approving or, in the extreme case, withdrawing approval, of a plan, not in ordering changes once the plan has been agreed to and approved. Here again, the Commission's experience with the Southwestern Bell

Telephone plan illustrate this point. As Southwestern Bell's first alternative regulation plan drew to a close, proceedings were held before the Commission to evaluate the operation of that first plan and whether a second plan should be established. The parties before the Commission, including Southwestern Bell, made various proposals for such a second plan. The Commission declined to embrace any one proposal, but instead, after its review of the record, fashioned its own plan that it concluded satisfied its duty to ensure the establishment of just and reasonable rates. *See Re Southwestern Bell Telephone Co.*, 1993 Mo. PSC LEXIS 62, at * 221-29. As the Commission put it, "The Commission has concluded that it has the necessary authority to approve a reasonably structured alternative regulation plan, as described in this Report and Order, and that a company may voluntarily agree to operate under such a plan." *Id.* at * 221-22.

In other words, the Commission said to a regulated company, "Here's the deal for sharing your earnings with your customers. If you want to do this, this is how it will work." In the context of the Southwestern Bell proceeding, the company, as was its right, declined the offer. In this case, the signatories had worked out a deal in advance that was acceptable to them, and then presented it to the Commission. The Commission accepted the EARP as written by the parties, but it did not have to do so, and in fact approved the EARP only after making the judgment that "the rates established are just and reasonable and that the establishment of an alternative regulation plan is in the public interest." Report and Order, Case No. ER-95-411, at 7 (July 21, 1995).

In short, OPC's argument proves too much. If the Commission's duty to ensure just and reasonable rates allows it to compel the change in the calculation of the credit here -- essentially saying to UE, "we think you should pay a larger refund than the one that would be calculated under the deal you agreed to" -- then the Commission should by the same reasoning have the authority to order a refund of earnings outside of any alternative regulation plan. That, of course, is not the law: the Commission has no such power.

OPC does cite to a provision of the Agreement in aid of its argument, entitled "Commission Rights," which it quotes in its brief. OPC Br. at 10. That provision states that nothing in the Agreement is intended "to impinge or restrict in any manner the exercise by the Commission of any statutory right." Yet this provision on its face does not *give* the Commission any power it does not already have. It simply recognizes that this Agreement does not interfere with the statutory rights already given by the Legislature to the Commission. Once more, the law is absolutely clear that the Legislature has not given the Commission any power to order a utility to refund earnings or to change the terms of a utility's voluntary undertaking to do so. Simply put, no statutory right or power of the Commission is at issue here. Indeed, no one in these proceedings has even attempted to make any argument that such a power exists, preferring instead to glide over that essential point and offer conclusions that simply assume such a power exists, as OPC does here. Such argument offers the Commission no lawful basis to accept the proposed adjustments, but serves only to "hide the ball," a ball which, should the Commission adopt the proposed adjustments, reviewing courts will hardly fail to see.

### B. The Commission Does Not Have the Authority Under the Agreement to Order the Proposed Adjustments.

1. In addition to their allusions to some independent authority the Commission might have to order the proposed adjustments, the Staff and OPC both claim that the

Agreement itself gives the signatories the power to propose, and the Commission to order, such adjustments, pointing to sections 3.f.vii and 3.f.viii of the Agreement, and section 2.g of the Reconciliation Procedure (which is nearly identical to section 3.f.vii). Here again, as the parties with the burden of proof, the Staff and OPC have fallen far short, simply relying on what amounts to the claim that these provisions mean what they say they mean. *See, e.g.,* OPC Br. at 9. Yet neither the Staff nor OPC have explained how these provisions could possibly mean what they say they mean. While we, using well-established canons of contract interpretation, have shown that the text of these provisions do not support the Staff's and OPC's interpretation, UE Br. at 27-28; that the context of these provisions contradicts that interpretation, *id.* at 28-33; that that interpretation conflicts with the object and purpose of the EARP, *id.* at 33-37; and that that interpretation -- allowing one party to compel a retroactive change in the Agreement -- would render the Agreement illusory and unenforceable. *Id.* at 37-39.

Indeed, those consequences of the Staff's and OPC's interpretation mean that even if the Commission were to hold, wrongly, that the proponents of the adjustments did not have the overall burden of proof here (and in some fashion remedied the procedural due process problem that would cause), the Staff and OPC would still have to show how the provisions of the Agreement that they contend authorize their adjustments in fact do so clearly and unambiguously. This standard that the Staff and OPC would have to meet for their interpretation to prevail was illustrated by the Eighth Circuit Court of Appeals in *In re Workers' Compensation Refund,* 46 F.3d 813 (8th Cir. 1995). The case involved a challenge to a Minnesota statute, on Contract Clause grounds among others, that sought to retroactively redistribute excess premiums paid into Minnesota's workers' compensation regime. The rights and responsibilities of the insurance companies that participated in the system and the state entity that collected premiums and made payments from the funds collected were set out in several documents that created a contractual relationship between these parties. *Id.* at 818. The state officials involved in defending the new statute claimed that this contract was not breached because those documents contained a paragraph that provided that the terms of the agreement would be automatically amended to conform to any change in Minnesota law. As a result, these state officials argued, "[T]he changeable nature of an amendable contract prevents impairment of such contract by amendment." *Id.* As the court went on to explain this argument, "In other words, they contend that the insurance companies were on notice that their contracts with [the state agency] could be retroactively changed." *Id.* Like these Minnesota officials, the Staff and OPC here claim that the Agreement itself creates the power to change the methodology for calculating UE's return on equity and to apply that change to a past sharing period.

Though the text of the agreement at issue in *Workers' Compensation Refund* came much closer to supporting the Minnesota officials' argument than the Agreement in this case supports the claim of the Staff and OPC, the Eighth Circuit rejected those officials' interpretation in words which are instructive here:

> This contention [that the contracts with the state agency put the insurance companies on notice that their contracts could be retroactively changed] is unsupported in the law. The cases which find that notice existed due to an automatic amendment provision address prospective, not retroactive, amendment and notice. . . .
>
> This difference is critical. Unlike retroactive amendment, prospective amendment does not affect settled plans or arrangements. An expansive interpretation of the automatic amendment clause to permit complete retroactive amendment essentially deems all rights or obligations in those contracts illusory, because these rights could always be changed or

> obliterated. . . . An expansive retroactive application also converts the automatic amendment clause into a blanket waiver of the insurance companies' right to Contract Clause protection. Contractual clauses purporting to waive constitutional rights must be clear and unambiguous.

*Id.* at 818-19 (citations omitted).

Here, the scope of the Staff's and OPC's position is every bit as significant -- threatening to obliterate UE's contract rights and Contract Clause protection -- as was that of the Minnesota officials in *Workers' Compensation Refund.* Recall that the Staff and OPC believe that section 3.f.vii of the Agreement and section 2.g of the Reconciliation Procedure allow them to propose, and the Commission to order, adjustments not contained in the Reconciliation Procedure because it allows them to raise any "issues" they believe appropriate to raise. *See* UE Br. at 24-27. Recall also that since no other provision in the Agreement limits the scope of this alleged power to amend the terms of the Agreement, *any* aspect of the Agreement, including the sharing grid itself, could be subject to this power to retroactively change the bargain here. *See, e.g.,* Staff Br. at 20 ("Mr. Trippensee testified that there was nothing in Section 3.f.vii or Attachment C, Reconciliation Procedure that limits or restricts the Staff's or OPC's review to items specifically set out in Attachment C, Reconciliation Procedure."). The Staff, to be sure, denies that they would use this power to change the sharing grid, *see* UE Br. at 25, but they conveniently forget that what they are proposing here would in effect change the amount of any refund every bit as effectively as changing the percentages on the sharing grid.

In *Workers' Compensation Refund*, the Eighth Circuit concluded that the contract provisions there were not clear and unambiguous enough to create the power of retroactive amendment claimed by the state officials. *Id.* at 819. Here, the interpretation urged by the Staff and OPC is much farther removed from the actual text of the Agreement than was the interpretation rejected in *Workers' Compensation Refund* from its contract language; certainly, it is no less ambiguous, as the Staff testimony seems to reflect. *See* Surrebuttal Testimony of Robert E. Schallenberg ("Schallenberg Surrebuttal") at 15 (lines 3-4) ("I would agree that SBIRE and EARP are both documents that are ambiguous and unclear, especially in the monitoring area."). Plainly, the text relied on by the Staff and OPC does not clearly and unambiguously convey the meaning they wish to give to it, and, under the teaching of the Eighth Circuit, their interpretation should be rejected.

2. The Staff and OPC apparently also claim that the adjustments proposed here are what the Staff believes to be of the same kind that the Staff could propose under the "monitoring functions" of the Southwestern Bell Incentive Regulation Experiment (the "SW Bell Plan"). The UE EARP, according to this argument, allows for similar monitoring because the EARP uses some language similar to, or in some cases very close to, language used in the Southwestern Bell Plan. *See, e.g.,* Schallenberg Surrebuttal at 6 (lines 1-4) (Exh. No. 3); Staff Br. 11-20.

The complete, and obvious, answer to this claim is that the Southwestern Bell Plan contains no provisions that in any way, much less clearly and unambiguously, give one party and the Commission power to change the methodology for calculating the sharing credit. *See In the Matter of an Incentive Plan for Southwestern Bell Telephone Company*, Case No. TO-90-1 (March 15, 1991)("SWB Plan"), at 32-36 (Exh. No. 22)("Monitoring Procedures" section of Southwestern Bell Plan that sets out both the terms of calculating Southwestern Bell's earnings and monitoring its accounting).

Moreover, there is no statement in the Agreement, or anywhere else, that indicates the signatories to the UE EARP were adopting some "monitoring practice" of the Staff under the SW Bell Plan. *See, e.g.*, Tr. (Schallenberg), at 529-30 (lines 16-10)(acknowledging that there is no statement in the Agreement that the EARP was to operate according to the Staff's understanding of its monitoring procedures under the SW Bell plan). Indeed, there exists no clear statement of what the Staff's interpretation of its powers under the SW Bell Plan were. Neither the SW Bell Plan, nor any of the language in that Plan borrowed for use in the UE EARP, gives any clue of what that interpretation might be. This point was demonstrated in an exchange Commissioner Murray had with Mr. Schallenberg:

> Q. (Commissioner Murray) Mr. Schallenberg, assuming that UE knew about the Southwestern Bell document and the language in it and voluntarily incorporated provisions of that document into the language in the Stipulation and Agreement that we have before us here, did that in any way indicate that UE knew how the Staff was interpreting the SWB agreement?
>
> A. (Mr. Schallenberg) Not at all.

Tr. (Schallenberg), at 526-27 (lines 22-4).

At best, as the record shows, the expectations of the Staff with respect to the SW Bell Plan were just that, expectations of the Staff that were never memorialized in written form in the SW Bell Plan or the Agreement here, and certainly not communicated to UE. *See* Tr. (Schallenberg), at 494 (admitting that he did not know the state of UE's understanding of the SW Bell Plan when it was negotiating the EARP). *See also* PFOF No. 27.

The proceedings in which the EARP was presented to the Commission did not make these expectations more concrete, and certainly did not have the effect of making those expectations part of the contract between the signatories of the Agreement. Even if the references to the SW Bell Plan during those proceedings had conveyed something of substance about the SW Bell Plan, the oral comments of one party to a contract, like those of the Staff during those proceedings, can hardly amend a written contract. But when those comments are more fully examined in the context of that proceeding, it quickly becomes apparent that they did not describe a power to amend the contract like that now claimed by the Staff and OPC. *See, e.g.*, Staff Br. at 15 (quoting EARP Presentation (Exh. No. 47), at 13 (The EARP includes a rigorous monitoring the UE's financial data similar to the monitoring of Southwestern Bell.), at 14 (The one-time credits in the EARP are similar to those in the SW Bell Plan.), at 36 (In response to a specific question about the EARP monitoring procedures, which do not include the calculation of the credit, Mr. Dottheim observes that those provisions track the similar provisions in the SW Bell Plan.).)

The Staff has also suggested that the fact that Southwestern Bell did not respond in writing to the substance of their proposed adjustments before that case was settled implies Southwestern Bell somehow accepted those adjustments. Yet, as the few documents from those proceedings introduced by the Staff show, those proceedings were settled shortly after the issues had been identified and a schedule for the submission of testimony had been proposed. *See* Schallenberg Surrebuttal, Schedule 2, at 3-4 (Exh. No. 3). Since in that case, as eventually became clear here, involved no claim of manipulation (which requires an initial determination by the Commission of "whether a question of manipulation exists and should be heard," SWB Plan, at 34 of 75), there would be no reason for Southwestern Bell to set out its objections before the submission of testimony. Moreover, all those documents show with respect to the Staff's position is a brief list of "areas of disagreement" with no explanation of the basis of the Staff's position. This record does not show whether a particular "area of disagreement" involved a dispute over how a particular provision of the SW Bell Plan was to be interpreted, or whether, like here, such a disagreement arose because the Staff was seeking to add to or change the methodology in the SW Bell Plan. Thus, not only is the Staff's position not set out clearly in the Southwestern Bell proceedings, because that case was not fully litigated, it produced no ruling on whether the Staff's position, whatever it was, was lawful.

In short, the Southwestern Bell case offers no support whatever to the notion that the Agreement here itself gave the Staff or OPC, and the Commission, power to retroactively (or prospectively) change the components of the Reconciliation Procedure, or of any other aspect of the Agreement.

## III. THE STAFF AND OPC HAVE FAILED TO ESTABLISH THAT THE INDIVIDUAL PROPOSED ADJUSTMENTS BRING UNION ELECTRIC'S CALCULATIONS OF ITS EARNINGS INTO COMPLIANCE WITH THE AGREEMENT OR ARE OTHERWISE SUPPORTED BY SUBSTANTIAL AND COMPETENT EVIDENCE.

### A. No Substantial and Competent Evidence in the Record Supports Any Adjustment to Union Electric's Accounting for the Costs of Computer Maintenance Associated With the Year 2000 Problem.

1. The Staff proposes that UE's Year 2000 computer maintenance expenses be deferred until some later date because the Staff does not even know whether these expenses were prudent, while OPC claims they should be capitalized. Putting aside for the moment the issue of whether either of these courses is proper under the Agreement, this difference in conclusions, while not necessarily a "smorgasbord" of different options,

*see Re Terre Du Lac Utils. Corp.*, 1983 Mo. PSC LEXIS 44, at *24, 26 Mo. P.S.C. (N.S.) 165, certainly illustrates a divergence of view revealing that no coherent body of substantial and competent evidence is either animating the Staff and OPC or has been offered to the Commission to support these different proposals.

2. Indeed, the briefs of the Staff and OPC offer only conclusions, or mischaracterizations of the evidence, confirming yet again that there is no substantial and competent evidence to support their proposed handling of Year 2000 expenses. OPC's position, that these expenses should be capitalized, really is similar to their proposed adjustment for computer software development costs, and will be discussed below. The Staff, however, concludes that the Company's Year 2000 software maintenance expenses are "extraordinary," or "unusual and nonrecurring," and represent a new category of costs under Section 3.f.viii of the Agreement, and thus can be deferred so their prudence and accounting can be evaluated at some future date. Yet not one of the steps of what must be the reasoning under each of these conclusions is supported by *any* competent evidence.

Take, for example, the claim that these costs represent a new category of costs. One would think that, to make this judgment, one would look at other similar expenses to see how, if at all, the Year 2000 maintenance costs are different from those similar expenses. This the Staff did not do. They did not even look to see if UE had similar expenses, so they cannot even offer the Commission a reliable judgment that there are no such similar expenses in UE's operations. *See* Brief at 56-57. The Staff's logic is circular: because "Y2K costs have not been presented to the Commission for recovery prior to the instant proceeding," Staff Br. at 40, those costs trigger Section 3.f.viii. But that provision addresses new *categories* of costs. By the Staff's reasoning, the treatment for nearly any cost can be seen as unresolved by the Reconciliation Procedure as long as it has something distinctive about it. As we explained in our opening brief, such an interpretation would inflate Section 3.f.viii far beyond its scope, Brief at 54-55, and would turn it into a kind of omnibus adjustment mechanism, making any other provision dealing with the accounting methodology nearly superfluous. Finally, of course, we did offer substantial comparative evidence -- though hardly all we could have offered -- to show that the Year 2000 maintenance expenses were not different from other software maintenance costs UE regularly must bear. *See* PFOF No. 43.

Likewise, the Staff points to no comparative evidence supporting the notion that Union Electric's Year 2000 maintenance costs are "extraordinary" or "unusual and nonrecurring." Instead, they make general statements and imply they describe UE, or refer to requirements of federal law, reflecting the importance of the Year 2000 issue as a national matter, but which are hardly focused on UE's particular situation, again implying UE's compliance with those requirements indicates the unusual nature of these expenses.

For example, the Staff says this: "Thus, *a significant number of the computer systems based on two-digit years* are not programmed to identify the start of the new century, unless they have been recently modified." Staff Br. at 37 (emphasis added). The next sentence then says: "The Staff's Y2K costs adjustment is related to the work performed by UE to modify its computer software to address the above problem." *Id.* Read together, these statements convey the idea that a "significant number" of UE's computer systems will be disabled by the Year 2000 problem if not repaired, and that, when one is talking about such a number of computer systems of a utility that operates a nuclear power plant, such a disabling of computer systems truly would threaten the most extraordinary consequences. None of this is true, though of course since the Staff did not really examine UE's Year 2000 software maintenance activity, or compare it with the other maintenance of mission-critical computer software, they are not in any position to appreciate this fact. But they should, since the record is now replete with evidence explaining that, for UE, the Year 2000 problem has turned out not to be nearly as serious as it might be for other companies in other sectors of the economy, and certainly is not as significant as the other maintenance UE must undertake to ensure the reliable operation of its computer systems dealing with operational safety and security. *See* Brief at 64-67.

Perhaps the most striking attribute of the Staff's argument -- underscoring how unsubstantial their position on these computer maintenance costs really is -- is the fact that they still insist on representing a gross figure from an early estimate of all Year 2000 related costs, that is $10 to $15 million, as an accurate number for the costs at issue here: computer *software* expenses relating to UE's *Missouri* operations. The true numbers are closer to $2 ¼ to $4 ¼ million, as the unchallenged evidence in the record established. *See id.* at 63-64. It is strange indeed that the Staff uses the monitoring procedures as a basis to argue that they have the power to propose adjustments to UE's calculations, while, in the case of these Year 2000 expenses, they did not use those procedures to first determine what UE's calculations actually were. *See id.* at 63 n.8.

Because the proposed adjustments relating to Year 2000 expenses are not appropriate under the Agreement, and are not otherwise supported by substantial and competent evidence, they must be rejected.

### B. No Substantial and Competent Evidence in the Record Supports Any Adjustment to Union Electric's Accounting for the Costs of Computer Software Development.

1. Both the Staff and OPC claim UE's costs for the development of computer software for three new computer systems should have been capitalized instead of expensed. Yet they offer no evidence to suggest that this treatment was in any way in violation of the Agreement, inconsistent with UE's past practice,[5] or at odds with GAAP or the Uniform System of Accounts at the time.[6] To be sure, this was the point of Commissioner Crumpton's inquiry to Mr. Brandt. In Commissioner Crumpton's words:

> Really the only thing you have to show in my opinion is, No. 1, that you have some expenditures for software and, No. 2, that Staff did not say they were imprudently incurred or Staff did not say you should not have expensed these items, they should have been carried out over time.

Tr. (Crumpton), at 273 (lines 2-7). Exhibit No. 47 produces the information Commissioner Crumpton asked for, that is, it demonstrates that UE expensed computer software costs in its last litigated rate proceeding (EC-87-114 and EC-87-115), without any objection from the Staff. This is not to say that the Staff waived, in some legal sense, its ability to object to this accounting treatment by not objecting at that time, a strawman the Staff sets up and then knocks down. Staff Br. at 49. It *does* suggest, however, that

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5 The Staff notes that UE's past practice is not "monolithic," Staff Br. at 55, which, though true, is an observation that leaves us puzzled as to its relevance. As Mr. Baxter testified, when UE purchases software embedded in a mainframe, it is impossible to determine which portion of the cost is attributable to the software and which to the hardware. *See* Brief at 70. In that case, UE capitalizes the total sum. *Id.* Since none of the software involved here was embedded in hardware, expensing this software was not inconsistent with that practice.

6 At points, both the Staff and OPC simply assume their conclusion -- that software costs should be treated as assets and capitalized -- and then build arguments based on that conclusion. *See, e.g.*, Staff Br. at 47 (arguing that CSS was not "in service" during the third sharing period, and so its costs should not be included); OPC Br. at 16 (arguing that CSS was not "used and useful" during that period and should be treated like construction work in progress). Yet they do not and cannot deny that by any official measure there was nothing inappropriate about UE's longstanding policy of not treating software as an asset, but expensing software costs as incurred.

there was nothing inherently problematic in expensing computer software costs before GAAP changed, since the Company has been following that accounting treatment for quite some time without objection. Indeed, following the logic of Commissioner Crumpton's question, Exhibit No. 47 should fully resolve this issue in favor of UE.

Nevertheless, the Staff claims that these costs represent a new category of costs because there never has been a "prior decision of the Commission that pronounces that software costs should be expensed." *Id.* Yet during a ratemaking the Commission "pronounces" on only a fraction of the accounting treatments used by a utility to calculate its cost of service, and it makes such a pronouncement generally because some other party has a problem with a particular treatment and raised it as an issue. To adopt this standard as the meaning of section 3.f.viii would be yet another way in which that provision would be stretched far beyond its meaning. Why would the parties take the trouble to negotiate the details of the Reconciliation Procedure if they were going to leave such a vast loophole? The Staff does not say, nor indeed offer any evidence that section 3.f.viii has such a meaning.

The Staff does offer *Missouri Gas Energy*, Case No. GR-96-285, 1997 Mo. PSC LEXIS 10 (Jan. 22, 1997), as an example of Commission action on the accounting for software costs, specifically ordering a 10 percent depreciation of those costs. Staff Br. at 49-50. Yet as we pointed out in our opening brief, what was being depreciated in *Missouri Gas Energy* was both hardware and software (hardware obviously has a longer useful life), and both depreciation and the particular rate was proposed by the utility in the case. No broad finding that capitalization is the appropriate accounting treatment for software costs in different contexts was involved. *See* Brief at 76.

2. Here again, the Staff does not have its facts right. The Staff again incorrectly recites a figure for the CSS system, Staff Br. at 51, that far exceeds the true figure. *See* Brief at 73-74.[7]

Similarly, the Staff correctly notes the "age" of the customer information system that CSS is replacing, Staff Br. at 50, but also fails to recount the point Mr. Baxter made at the hearing. That is, the numerous software modifications made to that system over the years means that the current version of that system does not resemble the system as it looked when it first came on line; indeed, the "system that you put in place [ ] years ago probably isn't there anymore." Tr. (Baxter), at 816-17 (lines 20-12). In short, the overall age of the old customer information system does not suggest what the useful life of its software is, even assuming that information would be relevant here.

3. Finally, the Staff's extended discussion of the interplay between SOP 98-1 and FAS 71 -- a complicated and technical accounting issue on what must be done for UE to *prospectively* change its accounting for software for ratemaking purposes -- seems irrelevant to any issue before the Commission now. *See* Staff Br. at 59-62. There is no dispute that the GAAP rules governing the accounting for software changed *after* the period relevant to this case.

As Mr. Baxter testified, while the EARP remains in force, the signatories could get together to amend the Agreement going forward to conform to the new GAAP rules. Tr. (Baxter), at 792-93 (lines 12-8). That is the substantive question. Whether execution of that change requires a Commission order to comply with the terms of FAS 71 is more of a procedural issue that would appear to be easy to resolve once the signatories agreed

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7 As we did in our opening brief, we are not repeating confidential numbers here given the ready availability of those numbers in material in the record.

on the substantive point. We must point out, of course, that we offered the testimony of an independent expert, Mr. McKnight, and of Mr. Baxter, both of whom have long experience dealing with GAAP, who concluded that Commission action was necessary to make such a change. *See, e.g., id.* at 789-94. The Staff offered no competing testimony of equivalent stature.

In short, the Staff has offered the Commission nothing to change the conclusion that ordering the adjustment proposed by the Staff and OPC to capitalize the computer costs incurred in the third sharing period would be in violation of the Agreement and unsupported by substantial and competent evidence, and so arbitrary, capricious, and an abuse of discretion.

### C. The Staff's Proposed Adjustment to Injuries and Damages Expenses Is Foreclosed by the Agreement, and Would Be Irrational and Unfair.

1. At the outset of its treatment of the proposed adjustment to injuries and damages expenses, the Staff makes a concession and is, apparently, unaware that it is making a concession. The Staff writes, "the EARP Reconciliation Procedure is silent on the treatment of injuries and damages expense during the duration of the EARP." Staff Br. at 80. Such silence should, of course, end the discussion and foreclose any consideration of an adjustment unmentioned in the text of the Reconciliation Procedure itself. The Reconciliation Procedure contains detailed instructions for the methodology to be used by the Company in calculating earnings; it lists over a dozen adjustments to the Company's books and records; the Agreement itself states that the "[t]he return on common equity for determination of 'sharing' *will be calculated* by using the methodology set out in [the] Reconciliation Procedure," Agreement, § 3.f.i (emphasis added); the very next section of the Agreement provides that the signatories "conferred

and determined what items . . . should be excluded from the calculation of UE's return on equity. *Those items are identified in [the Reconciliation Procedure],*" *id.*, § 3.f.ii (emphasis added). Simply as a matter of common sense,

the inescapable inference from this string of undisputed facts is: *where the Reconciliation Procedure is silent, no adjustment was intended by the parties to the Agreement.*

The Staff's proposed adjustment to injuries and damages expenses is not absurd as a matter of common sense alone. As a matter of law, "when parties reduce their agreements to writing it is presumed that the instrument contains their entire contract. . . ." *Conservative Fed. Sav. & Loan Ass'n v. Warnecke*, 324 S.W.2d 471, 478 (Mo. App. 1959); *see also Glass v. Mancuso*, 444 S.W.2d 467, 478 (Mo. 1969) (deeming an omission "intentional" in the absence of affirmative evidence that the parties intended the additional term). As the court in *Conservative Federal* explained, "[n]o implied provision can be inserted [into a contract] to supply an obligation concerning which the contract is intentionally silent." *Conservative Fed. Sav. & Loan*, 324 S.W.2d at 480; *see also Johnson v. Thompson*, 251 S.W.2d 645, 647 (Mo. 1952) ("The express declaration puts to an end anything that silence might signify."). Remarkably, the Staff acknowledges that the 1987 Complaint Case again UE is the only precedent for an adjustment to UE's injuries and damages expenses. The signatories to the Agreement took care to incorporate three adjustments from the 1987 case into the Reconciliation Procedure. *See* UE Br. at 80-81 (discussing *The Staff of the Missouri Public Service Commission v. Union Elec. Co.*, Case No. EC-87-114 & EC-87-115 ("1987 Order")). The Staff seeks to add an adjustment from the 1987 Order that the signatories deliberately omitted from the Reconciliation Procedure. This, of course, they cannot do. *See, e.g.*, *General American Life Ins. Co. v. Barrett*, 847 S.W.2d 125, 133 (Mo. App. 1993) (in construing a contract, "the mention of one thing implies exclusion of another")(quoting *Black's Law Dictionary* 521 ($5^{th}$ ed. 1979). In short, why would the drafters of the Agreement bother *explicitly* to incorporate certain adjustments from the 1987 Order if they intended to allow parties to raise other *unspecified* adjustments from that Order? To this question, the Staff has no answer.

Undaunted by the text of the Agreement, the Staff writes that it "reads [the Agreement] as allowing it to propose adjustments to UE's booked results where there is a significant variation in the level of expense and a reasonable explanation has not been provided." Staff Br. at 81. The Staff couches its argument in a phrase drawn from the Agreement, although it rips that phrase out of context and therefore mangles its meaning. Specifically, Section 3.f.vii provides that the parties can bring to the Commission's attention an allegation of manipulation, adding that "[a]n allegation of manipulation could include significant variations in the level of expenses associated with any category of costs, where no reasonable explanation has been provided." Here, however, the Staff has forthrightly acknowledged that it "is not alleging 'manipulation' as the basis for proposing its adjustments." Staff Br. at 18. The Staff thus on the one hand borrows definitional language relating to "manipulation," although on the other hand it concedes that it is not claiming manipulation. Nor, in any event, *can* the Staff allege that the Company failed to supply a "reasonable explanation." It is undisputed that UE used the same accounting methodology to calculate injuries and damages expenses in the Third

Sharing Period that it had in the First and Second Sharing Periods, as well as prior to the EARP, a methodology prescribed by GAAP.[8]

2. Even if the Staff were not contractually foreclosed from proposing an adjustment to the Company's injuries and damages expenses, the Commission should still reject the proposed adjustment as irrational and unfair. As set forth in our opening brief, the grafting of expense normalization and cash basis accounting violates elementary principles of accounting and ratemaking. UE Br. at 82-84. The Staff's opening brief confirms that its methodology arises from a remarkable ignorance of basic accounting principles. The Staff blithely notes that its methodology "eliminates reliance on future estimates, instead *giving full recovery of actual claims paid out*, plus whatever amount is necessary to restore the reserve to a historically reasonable level." Staff Br. at 82 (emphasis added). *The insinuation -- that the Company will recover all its injuries and damages expenses -- is false.* The following table reflects that, under the Staff's methodology, the Company confronts the possibility that it will never recover $2.5 million in expenses:

[8] The Staff alternatively seeks support for its adjustment in Section 3.f.vii of the Agreement and Section 2.g of the Reconciliation Procedure because this is "an issue relating to the operation and implementation of the plan" Staff Br. at 81. As discussed earlier, the Staff's interpretation of these provisions would transform the remainder of the Agreement into a nullity. *See* UE Brief at 27-39.

| | Third Sharing Period EARP 1 | First Sharing Period EARP 2 | Second Sharing Period EARP 2 | Third Sharing Period EARP 3 |
|---|---|---|---|---|
| | (In Millions of Dollars) | | | |
| Injuries and Damages Expense | 20 | 17 | 15 | 20 |
| Injuries and Damages Payments | 17 | 17 | 15 | 20 |
| Expense/Payout Adjustment Under Staff Methodology | -3.0 | 0 | 0 | 0 |
| Reserve Adjustment Under Staff Methodology | +0.5 | 0 | 0 | 0 |
| Total Adjustment Under Staff Methodology | -2.5 | 0 | 0 | 0 |

If, for each of the three years of the Second EARP, the Company's injuries and damages expense is roughly equal to its injuries and damages payment, and the reserve stays roughly constant, then the Company will *never* recover the $2.5 million in expenses disallowed in the Third Sharing Period.[9] On this issue, it is worth hammering again the fact that the Staff did not propose its novel methodology in the First Sharing Period, when the Company's expenses had declined dramatically, and thus the adjustment would have redounded to the Company's benefit (and the ratepayers' detriment). How curious that the Staff should have waited to bring its "concern" to the Commission's attention until the Third Sharing Period, when its adjustment works to the dramatic disadvantage of the Company. UE Br. at 83-84.

[9] It is also possible, as we note in our opening brief, that UE might overrecover if the Commission adopts, on a going-forward basis, the Staff's methodology. UE Br. at 84. If the Company makes cash payments in a Sharing Period in excess of the provision, then the Company would irrationally benefit from the Staff's methodology. Thus, the Staff's methodology perversely incents UE to quickly settle any outstanding claims; for it is penalized for making a provision for a claim in a given Sharing Period (as it is required by GAAP) and not making a cash payout, possibly for an unrelated claim, in that same Sharing Period. Ultimately, of course, UE and its customers will be injured by the Staff's methodology, for it will

Staff (Br. at 83), is the Staff's failure to apprehend the difference between a sharing credits proceedings and an ordinary ratemaking proceeding.[10]

In sum, the Staff's proposed adjustment to injuries and damages expenses betrays the Staff's faulty understanding of the Agreement, the nature of this proceeding, and basic accounting principles. For all of these reasons, the Commission should reject the Staff's proposed adjustment.

### D. The Adjustment to Reflect the Untimely Decommissioning Fund Deposits is Inappropriate Under the Agreement, and Does Not Correctly Calculate the Company's Cash Working Capital Benefit.

1. With regard to the Staff's and OPC's proposed adjustment to reflect the untimely decommissioning fund deposits, the issue is joined and only a few points need to be made. First, there is a threshold dispute as to whether this adjustment is permitted under the Agreement. The Staff acknowledges that the use of monies earmarked for the decommissioning fund constituted a cash working capital benefit to the Company. The Staff further acknowledges that a provision in the Reconciliation Procedure contemplates that the Company is required to reduce its rate base by $24 million to reflect a cash working capital benefit. The Staff argues, however, that monies held by the Company prior to its March 1998 deposits are "in addition to the monies that were the basis of the negotiation of the $24 million cash working capital rate base offset." Staff Br. at 89.

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10 The Staff also repeats the bromide that GAAP is not binding for ratemaking purposes. No one is contesting that the Commission has the authority, after the Second EARP, to require, on a prospective basis, that the Company use an accounting methodology that diverges from GAAP. This proceeding, however, is governed by the Agreement. That Agreement requires the Company to use the accounting methodologies set forth in the Reconciliation Procedure. Where no adjustment is specified therein, the Company is required, under the Reconciliation Procedure, to compute its earnings in accordance with its past practice. The Company complied with the terms of the Agreements: it calculated its injuries and damages expense in accordance with its past practice, which is consistent with GAAP.

The Staff has failed to meet its burden of producing sufficient evidence to support this claim. The Staff witness who sponsored the adjustment acknowledged that she was not involved in the drafting of the Reconciliation Procedure, Tr. (Westerfield), at 887 (lines 3-6), nor did she know how the persons who negotiated the Agreement arrived at the $24 million figure, *id.*, at 888-89 (lines 20-2). In the absence of any evidence to support the Staff's claim that the decommissioning fund deposits are "in addition to the monies that were the basis of the negotiation of the $24 million cash working capital rate base offset," the Staff's argument should be rejected. *See, e.g., Re Missouri Public Service*, Case No. ER-97-394, *et al.*, 1998 Mo. PSC LEXIS 21 at *18-19 (Staff failed to meet its burden of producing evidence to support its adjustment).

Of course, the Staff's failure to supply any evidence on this point should not be surprising, for no such evidence exists. To the contrary, the persons who drafted the Agreement recognized that in any given year, the Company's total cash working capital benefit might be in excess of $24 million, or less than $24 million. It was even possible that the Company might experience a cash working capital detriment in a given year. (This might occur if the Company's cash flows were such that it did *not*, in total, have the use of monies over the course of a year.) The only way to know, with precision, the amount, if any, of the Company's total cash working capital benefit would be to conduct a lead-lag study -- that is, an analysis of UE's panoply of cash flows -- each year. Such an analysis, by the admission of the Staff's own witness, is extraordinarily time-consuming and complex. Tr. (Westerfield), at 889 (lines 3-15). It was in lieu of annual lead-lag studies that the drafters of the Reconciliation Procedure settled upon the figure of $24 million as an annual rate base offset. The only intellectually defensible support

As regards the claim that this circumstance is "extraordinary," the Staff has failed to supply any evidence to support this conclusion. And this is little surprising, for, once again, no such evidence exists. For an item to be considered "extraordinary," it "should be more than approximately 5 percent of income." Uniform System of Accounts, ¶ 15,017 (Exh. No. 30). Assuming, for purposes of argument, the generous estimates of the Staff and OPC, this item at most involves $300,000 -- which is less than 0.1% of the Company's annual income. *See* Tr. (Baxter), at 748-49 (lines 3-11).[12]

3. If the Commission concludes that the Agreement does not foreclose an adjustment, an adjustment in the amounts proposed by the Staff and OPC is still inappropriate. Until it receives an authorizing order from the Commission, the Company cannot make decommissioning fund deposits. Throughout the year 1997, UE waited for such a Commission order. Importantly, UE could not know when such an order would issue. The Staff and OPC have not disputed any of these facts, nor can they dispute the necessary inference from these facts: Because UE did not know when the Commission order would issue, it could not invest the monies earmarked for the decommissioning fund in plant construction. Alternatively put, UE needed to ensure that these monies were immediately available, because at any moment the Commission could enter an order authorizing the deposits. Thus, to the extent that UE was able to invest, and earn benefits from these monies, it was able to earn only short-term interest rates, and not the AFUDC rate.

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[12] The Staff also alleges that Section 3.f.vii supplies a basis for this adjustment. Staff Br. at 88. The Staff does not explain how this provision supports this adjustment, and the Company declines to speculate what the Staff intended.

Thus the appropriate interest rate for calculating this adjustment, if such an adjustment is to be permitted at all, is a short-term interest rate of 5-6%. The decommissioning fund deposits would be multiplied by the short-term interest rate for the appropriate number of days -- that is, the number of days that the deposits were delayed. The correct method of calculation is shown on Schedule 5 of Weiss Rebuttal; Mr. Weiss calculates the cash working capital impact of the delayed decommissioning fund deposits, and then reflects that impact in the rate base. Thus calculated, the adjustment would be in the amount of $177,000. UE Br. at 88.

### E. The Record Reflects that The Company Immediately Benefited from the Black River and Macon Territorial Agreements.

The Staff's opening brief confirms that the Staff has failed to satisfy its burden and support its territorial agreements adjustment. Although unable to produce any credible evidence on this issue, the Staff persists in proposing an adjustment in excess of $1 million. The Commission should take the opportunity afforded by this adjustment to remind the Staff that it, like any party that bears the burden of proof, must come forward with meaningful evidence before litigating an issue and consuming a company's and the Commission's resources. In its brief, the Staff continues the mantra that this adjustment is necessary to "reverse the effect on earnings of [the two] territorial agreements." Staff Br. at 68. But the question is *what* effect the territorial agreements had on the Company's earnings; and the Staff has not produced a scintilla of competent evidence to rebut the Company's position that the effect has been to increase net income.

#### 1. Black River

As an initial matter, the Staff continues to link its ability to raise an adjustment for Black River to the fact that it "reserved the right to address the ratemaking effect of these territorial agreements." Staff Br. at 67. The Company acknowledges that, with respect to the Macon agreement, the Staff sought to "reserve the right," and the Commission recognized such a reservation in its Order approving the Macon Agreement. It is undisputed, however, that the Commission recognized no such reservation in its Order approving the Black River Agreement.

In any event, the sum total of the affirmative evidence produced by the Staff to support its Black River adjustment spans one paragraph. Staff Br. at 69-70. Remarkably, that paragraph is nothing more than a recitation of scattered portions of testimony filed by the Staff and UE *in 1995*, when the territorial agreement was being reviewed by the Commission. The Staff notes that the Company estimated at that time that the exchange of customers would result in a decrease of "more than $400,000 of revenue." *Id.* at 70 (drawing from Mr. Rackers' work paper (Exhibit 27)). That work paper reflects that he compared "Ameren UE revenue prior to the exchange," or $3,035,384, and "Black River revenue prior to the exchange," or $2,600,463; and he then computed a decline in revenue in the amount of $434,921. The figures from Mr. Rackers work paper are, in turn, drawn from a schedule attached to testimony filed in the Black River proceeding in 1995 by the Company witness. *See* Schedule 2 to Exhibit 23 (Testimony of Kenneth Schmidt, dated June 30, 1995). A footnote to that schedule states that "revenue totals are based on one year ending in 1994." The upshot was made clear during the cross examination of Mr. Rackers at the hearing:

> Q. So turning to your work papers again, that $3 million figure, that's based on 1994 data. Correct?
>
> A. Yes.
>
> Q. Okay. And the $2.6 million figure, that's based on 1994 data. Correct?

A. Yes.

Q. Okay. And the $434,000 figure, that's the result of 1994 data. Right?

A. Yes.

Tr. (Rackers), at 594 (lines 4-13). In other words, the Staff bases its adjustment -- purportedly designed to reflect a comparison of revenue between the year 1995-1996 (pre-exchange) and the year 1997-1998 (post-exchange), and the sole factual predicate for the adjustment is data complied in 1994. Clearly, such evidence is not sufficiently "competent and substantial" to warrant a decision in the Staff's favor.[13]

Having failed affirmatively to support its Black River adjustment, the Staff turns to criticisms of the Company's calculations. The Staff notes that, pursuant to the territorial agreement, UE gave up 2,961 customers to the Black River Cooperative and received 2,992 (a net gain of 31 customers). UE witness Weiss compared the service areas in which customers were exchanged, and he demonstrated that a comparison pre- and post-territorial agreement reveals an *increase* in customers, sales, and revenues. Specifically, customers increased from 10,891 to 11,394 (a net gain of 503), and revenue increased from $23,533,998.06 to $24,002.294 (a net gain of $468,296.18). Exh. No. 29 (revised schedule prepared by Gary Weiss).[14] The Staff objects that the exchanged

[13] The staff also touts a projection performed by the Staff witness in 1995 (again, on the basis of 1994 data). Staff Br. at 70. Of course, there is no reason to accept the Staff's outdated *projected estimates* when the Company has provided *actual results*.

[14] The figures presented here for revenues and total customers pre- and post-exchange are slightly different from the figures presented in our Proposed Findings of Fact and Conclusions of Law (Nos. 96-99). The figures here are drawn from Exh. No. 29, which Mr. Weiss filed in response to a criticism raised at the hearing. In cross-examination, the Staff noted that Mr. Weiss's work paper (Exh. No. 28), which reflects a comparison of service areas in which customers were swapped, failed to include certain customers from St. Francois County. Exhibit No. 29 incorporates data from St. Francois County; it demonstrates that the positive effects of the Black River agreement were in fact *understated* in Mr. Weiss' original work paper. As reflected in Exhibit No. 29, the increase in net income from the Black River

Even leaving aside the matter of the burden of proof, and simply viewing the evidence both sides have adduced on the issue, the Commission should not credit the head-in-the-sand refusal to face facts that underlies the Staff's adjustment. The best the Staff can do to justify its proposed adjustment is dredge up *outdated data*. By contrast, the Company studied *actual results*, both before and after the territorial agreement. As Mr. Weiss testified, it would be impossible to compare results for the customers who were traded away to Black River, as UE of course does not have such data. Tr. (Weiss), at 625 (lines 13-17). Nor is it possible for the Company to track results for the customers received from Black River, as UE does not keep records to this micro-level. Tr. (Weiss), at 625 (lines 17-20). In lieu of the impossible comparison proposed by the Staff, the Company did the next best thing. It analyzed results for the service areas from which customers were traded. Thus, instead of comparing the roughly 3,000 customers that were exchanged, the Company compared the 10,000 customers, of which those 3,000 customers were a subset. It determined that there was an increase in revenues in the amount of nearly half a million dollars.

The Staff notes that "[n]one of the information that UE provided [has] caused [it] to change [its] analysis." Staff Br. at 72. The arbiter here, however, is that of a reasonable person. A reasonable person would realize that it is impossible to compare results for customers traded away and customers received. A reasonable person would realize that an alternative analysis would look to the service areas in which customers were swapped. A reasonable person would realize, moreover, that even such an analysis would understate the benefits that flow from a territorial agreement. A reasonable person

related," although "not completely unrelated to the issues herein." *Id.* at 72. Precisely how these original concerns were "not completely unrelated" is unexplained and inexplicable.

would not concoct an adjustment on the basis of five-year-old data. In short, a reasonable person would conclude that no adjustment is appropriate to "reverse the effect" of the Black River territorial agreement.

### 2. Macon

With regard to the Macon agreement, there is no dispute that the Staff has a "right to re-examine the financial impacts of the territorial agreement" for purposes of the EARP. UE Br. at 91 n.16; Staff Br. at 74-75. The only question relates to the results of such an examination. Once again, the Staff has failed to satisfy its burden of proving that the effect of the Macon Agreement has been to decrease net income.

In its opening brief, the Staff alleges that it has done a "detailed analysis . . . of the purported benefits and costs of the territorial agreement." *Id.* at 75. This is incorrect. The Staff did an "analysis" of each of the benefits and costs save one -- that of excess energy sales. Staff witness Rackers conceded that it was "possible" that the Company had such "excess energy capacity." Tr. (Rackers), at 601-602 (lines 19-3). Of course, as a matter of logic, no other conclusion is possible. Consider these two undisputed facts:

(1) The Company's ability to generate electricity was unaffected by the Macon agreement; and

(2) The Company had considerably fewer customers to service as a result of the Macon agreement.

It inexorably follows that as a result of decreased customer demand, the Company was able to either (a) sell excess energy on the interchange market, or (b) avoid purchases of energy on the interchange market otherwise necessary to serve its core customers.

Although the Staff acknowledges that it is "possible" that the Company reaped an economic benefit from its excess energy capacity, it did nothing to quantify that benefit.

The Staff's failure to conduct this elementary due diligence is not surprising in light of the Staff's ignorance of a pivotal fact:

> Q: [Y]ou didn't know when you sponsored your adjustments that the price for energy in June of 1998 had skyrocketed to the all-time high of $7,000 a megawatt?
>
> A: I didn't know that.

Tr. (Rackers), at 603 (lines 13-17). As we stated in our opening brief, the Staff concedes the possibility of excess energy capacity -- a possibility that is in fact a logical necessity -- and then it asks the Commission to assume that the Company did not sell that energy on the interchange market, where it would have been able to earn $7,000 a megawatt. UE Br. at 94.

Irrespective of which party bears the burden of proof, the Staff's adjustment should be rejected. When the burden is taken into account, however, the adjustment cannot seriously be considered. The Staff claims that an adjustment is necessary to reverse the effect of the Macon territorial agreement. The Staff bears the burden of proving precisely what that effect was. Here, the Staff has clearly failed to meet that burden, for it has failed to calculate the value of the Company's excess energy or justify its conclusion that that energy did not exist (or had no value whatsoever).

Instead of offering any affirmative proof as to the existence or value of the excess energy, the Staff contents itself with two cursory criticisms of the Company's effort to quantify the benefits: "Mr. Rackers challenges [the Company's] analysis in large part due to Mr. Weiss' calculation of $1.313 million in 'excess energy sales,' which Mr. Rackers contends (1) arbitrarily assumes that all reduction in usage in the summer cooling months will be available for sale by UE at the highest energy cost and

(2) includes twice in its calculation the highest cost of generation in the summer months." Staff Br. at 76. We consider these criticisms in turn.

The Staff's accusation that the Company "arbitrarily" valued its excess energy is the height of audacity. The Staff itself concedes the possibility of excess energy and then -- without a word of explanation -- in effect assigns that energy a value of $0. In discussions prior to the submission of testimony in this proceeding, the Company explained to the Staff that it had benefited from the excess energy arising from the Macon Agreement, and it defended its valuation procedure. Instead of proposing an alternative valuation, the Staff irrationally -- and arbitrarily -- assigned that energy no value at all. The Staff has acted in a manner inconsistent not only with common sense, but also with the fact that it bears the burden of proof on this issue. It is not enough to label the Company's valuation as arbitrary; the Staff needed to support *its* valuation.

Furthermore, the Company's valuation is a reasonable one. The Company concluded that the economic value of the excess energy is the incremental cost of supplying that energy, either internally (from the Company's plants) or externally (from the interchange market). Especially in the peak demand months of summer, internal sources of energy are substantially less expensive than external sources. Thus, the Company's valuation of its excess energy is a conservative estimate. Had the Company used the interchange market prices, and not the average highest cost incurred by UE, the valuation would have been considerably higher than $1.313 million.

The Staff's second objection is that the Company "includes twice in its calculation the highest cost of generation in the summer months." This statement is completely false, and reflects the Staff's oversight of the undisputed evidence introduced at the hearing. The Staff's point here is that the Company, when calculating the fuel savings that resulted from the Macon agreement, should not have averaged in the higher-than-normal costs of the summer months. (Recall that one of the assumptions of UE's excess energy calculation is that the Company was generating energy in the summer and selling that energy on the interchange market.) Mr. Rackers waited until his surrebuttal testimony to make this point; the Company recognized the plausibility of the criticism and took remedial measures. As Mr. Weiss explained at the hearing:

> In response to Mr. Rackers' surrebuttal testimony, page 11, lines 10 through 13, he pointed out that in pricing up my fuel savings, since I was also pricing up the sale of the excess generation during the summer months, I should price my fuel savings at the average of the fuel costs excluding the summer months. So I recalculated my fuel savings and that's when I came up with a number [reflecting total additional net revenue] changed to 196,847 on page 9 of my testimony.

Tr. (Weiss), at 754-55 (lines 18-1). Thus, as his work paper reflects (a work paper made available to the Staff at the hearing), Mr. Weiss removed the cost of generating energy in the summer, and accordingly reduced the average fuel cost from $14 to $12.99 per mwh. The Company correspondingly decreased its estimate of its fuel savings from $282,095 to $262,438. As Mr. Weiss explained at the hearing, the Company then recalculated its estimate of total additional net revenue, decreasing that figure by $19,657. In the end, the Company concluded that the net effect of the Macon territorial agreement was an increase in net revenue in the amount of $196,847.

In sum, the Staff's criticisms of the Company's calculations are unavailing. First, the Staff, not the Company, assigned an arbitrary value to the excess energy; and second, the Company did not double-count the summer months in calculating its fuel savings. More fundamentally, the Staff has failed to satisfy its burden of proof and support an adjustment for the Macon agreement.

### F. The Company Correctly Calculated its Merger Costs in Accordance with the Merger Agreement

The parties agree that the proposed adjustment to the Company's amortization of merger costs presents a straightforward issue of contract interpretation. There are two relevant sentences in the Merger Agreement:

> Actual prudent and reasonable merger transaction and transition costs (estimated to be $71.5 million, which reflects the total Ameren Corporation ("Ameren") estimated merger costs presented to the Commission Staff ("Staff") and Office of the Public Counsel ("OPC") in the UE/CIPSCO, Inc. Merger Implementation Plan, less executive severance pay of $1.6 million, but including costs incurred in 1995) shall be amortized over ten years beginning the date the merger closes. The annual amortization of merger transaction and transition costs will be the lesser of: (1) the Missouri jurisdictional portion of the total Ameren amount of $7.2 million; or (2) the Missouri jurisdictional portion of the total Ameren unamortized amount of actual merger transaction and transition costs incurred to date.

Merger Agreement § 4, at 2-3. It is the Company's primary submission that the two sentences quoted above are harmonious, the first sentence capping the amortization *period* at ten years, and the second sentence specifying the annual amortization *amount.* However, to the extent that there is any tension between the two sentences -- and the Company acknowledges that this section of the Merger Agreement may not be a model of clarity -- it is important to recall the basic principle of contract interpretation that a specific provision governs a general provision. UE Br. at 97.

To repeat, the Company -- unlike the Staff and OPC -- invites the Commission to consider *both* sentences. Although the first sentence speaks to an amortization period, the second sentence identifies a precise mechanism for calculating the actual amount to be amortized in any given year. "[W]hen one contract clause is general and inclusive and another is more limited and specific, the more specific clause acts to modify and '*pro* *tanto*' nullify the more general clause." *Transit Cas. Co. v. Certain Underwriters of Lloyd's of London*, 963 S.W.2d 392, 398 (Mo. App. 1998).

The Staff and OPC attempt various stratagems to overcome the unambiguous language of the Agreement. Primarily, they accuse the Company of slighting the sentence that they find so compelling. This accusation is rich in its irony, as it leveled by parties who themselves disregard language from the Agreement at odds with their own dubious interpretation. In both direct and surrebuttal testimony, Staff witness Gruner failed to quote, mention, or *even allude to* the second sentence of Section 4 of the Merger Agreement. In the same vein, the Staff writes in its brief:

> The Commission's own February 21, 1997 Report and Order adopts the first sentence by stating as follows at page 5 of said Report and Order "Actual prudent and reasonable merger transaction and transition costs (estimated to be $71.5 million) shall be amortized over ten years beginning the date the merger closes."

Staff Br. at 66. How odd -- and revealing -- that the Staff failed to quote the *very next sentence* of the Commission Order: "The annual amortization of merger transaction and transition costs will be the lesser of: (1) the Missouri jurisdictional portion of the total Ameren amount of $7.2 million; or (2) the Missouri jurisdictional portion of the total Ameren unamortized amount of actual merger transaction and transition costs incurred to date."

Besides simply ignoring the second sentence of Section 4 of the Merger Agreement, the Staff and OPC alternatively disparage the Company's interpretation as contrary to the signatories' intent. The Staff queries why the parties "would have agreed to [the Company's approach]," Staff Br. at 66, and OPC is equally puzzled: "It is illogical on its face to assume that a comparison would be expected between an estimated amortization and a total amount expended, because a ten-year amortization would always be less than (approximately one-tenth!) the total amount expended." OPC Br. at 22 (exclamation point in original). Basic math seems to have escaped the attention of both the Staff and the OPC. As currently estimated, the Company's merger costs will be approximately $66 million. Staff Br. at 64; OPC Br. at 21.[16] The following table sets forth the annual amortization amounts as calculated by the Company, the Staff, and OPC:

| Year | Amortization Amount UE Methodology | Amortization Amount Staff/OPC Methodology |
|---|---|---|
| 1 | 7.2 | 6.6 |
| 2 | 7.2 | 6.6 |
| 3 | 7.2 | 6.6 |
| 4 | 7.2 | 6.6 |
| 5 | 7.2 | 6.6 |
| 6 | 7.2 | 6.6 |
| 7 | 7.2 | 6.6 |
| 8 | 7.2 | 6.6 |
| 9 | 7.2 | 6.6 |
| 10 | 1.2 | 6.6 |

As the above table reflects, applying UE's methodology, in year 10 the total unamortized amount of merger costs will be $1.2 million, which is, of course, less than the $7.2 million. Thus, contrary to the OPC, the second sentence of Section 4 *is* rational: it prevents the Company from amortizing more than $72 million over ten years, and it prevents the Company from amortizing more than $7.2 million in any given year. In

[16] In its original brief UE mistakenly identified the current estimate of the merger costs to be $41-44 million. (That figure considers only merger transition costs, and fails to include merger transaction costs.) The correct merger costs estimate at this time is $66 million. *See* Gruner Direct, at Schedule 1. In connection with this brief, we have submitted corrections to the Proposed Findings of Fact and Conclusions of Law.

sum, the Company correctly interpreted the Merger Agreement in calculating its merger amortization costs

## CONCLUSION

For the foregoing reasons, as well as the reasons stated in our opening brief, all the proposed adjustments to Union Electric's earnings calculations in the Third Sharing Period should be rejected.

Respectfully submitted,

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## CERTIFICATE OF SERVICE

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